HOUSE OF COMMONS LIBRARY

BRIEFING PAPER

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Pre-pack administrations

By Lorraine Conway

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Summary

What is a pre-pack?

A pre-packaged administration (a pre-pack) is an arrangement under which the sale of all or part of a company's business or assets is negotiated with a purchaser prior to the appointment of the administrator, and the sale contract executed on the appointment of the administrator or very shortly afterwards.

When used appropriately, pre-pack administration can be an effective company rescue procedure. Pre-packs enable the sale of company assets to be undertaken quickly (reducing the likelihood of important contracts being lost), preserving the brand and the value of the business and, ultimately, returns for creditors. However, there are concerns about the transparency of the pre-pack administration procedure, in particular:

- where businesses are being sold to 'connected parties' (i.e. directors, shareholders and others connected with the insolvent company);
- possible conflicts of interest for the insolvency practitioner (for instance, when appointed by the floating charge-holder); and
- a lack of involvement of unsecured creditors.

To address these concerns, a Statement of Insolvency Practice (SIP 16) was issued in January 2009 (and periodically updated), with additional measures being introduced on 31 March 2011. The current SIP 16 came into force on 1 November 2015.

Following the publication of a Select Committee report in February 2013, the Government announced in July 2013 an independent review of the pre-pack procedure. The *'Graham Review into Pre-Pack Administration'* was published in June 2014 alongside *"Pre-Pack Empirical Research: Characteristic and Outcome Analysis of Pre-Pack Administration'* by the University of Wolverhampton. In response to the six recommendations made in the Graham report, the Government said it would work with business and industry to implement these recommendations in full. One of the key recommendations of the Graham report was that a pool of independent experts be set up in order to assess and give an opinion upon a proposed pre-pack sale to a 'connected party', but only if requested to do so by the connected party. On 2 November 2015, the Pre-Pack Pool became operational.

The *Small Business Enterprise and Employment Act 2015,* which received Royal Assent on 26 March 2015, implemented another Graham recommendation, creating a reserve power for the Secretary of State to legislate if necessary. This wide-ranging Act also introduced a number of measures to amend various parts of the current insolvency framework and modernise insolvency law by removing unnecessary costs and regulatory burdens.

This briefing paper looks in detail at how pre-pack administrations work in practice under revised SIP 16; the 'pros and cons' of the procedure; the recommendations of the Graham Review; and provides a summary of the measures introduced by the *Small Business Enterprise and Employment Act 2015.* This briefing paper applies to England and Wales, and Scotland.

1. Pre-pack administration

1.1 What is the pre-pack administration procedure?

Pre-packs are not new. They have often been used to sell businesses in insolvencies where commercial pressures require urgent action.

A pre-packaged administration (a pre-pack) is a planned insolvency procedure in which the sale of all or part of a company's business or assets is negotiated with a purchaser prior to the appointment of an insolvency practitioner as administrator.[1] The sale is then completed on the appointment of the administrator or very shortly afterwards. Pre-packs are a means by which administrators realise the assets of an insolvent company. The proceeds of sale are usually used to repay creditors in order to prevent them from exercising fixed charges[2], and to protect the company from liquidation.[3]

A phoenix company

The purchaser may be new to the company or a competitor but it is also possible that the purchaser may be the existing management. The directors of a failed company may wish to purchase its assets or business in order to form a new company. (This new company is sometimes referred to as a 'phoenix company' or a 'newco'). In 2011, the Insolvency Service estimated that 25 per cent of the 2,808 companies that entered administration in 2011 used the pre-pack procedure; and that nearly 80 per cent of pre-pack sales were to connected parties.[4]

A company is a separate legal identity

Many creditors who are owed money by a failed company are outraged to find that the directors of these companies may suffer little personal loss and are often able to start up a new business in the same field. To a certain extent, this is an inevitable consequence of limited liability. For the purposes of the law, a company is a separate legal entity and if it trades with limited liability its directors and shareholders do not usually retain liability for the company's debts should it become insolvent. However, there are rules in place designed to prevent an abuse of this privilege of limited liability.

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1 Since 26 May 2015, an administrator may now extend his term in office for up to a year (previously 6 months) by consent, without the need for a court application. This is provided for in s127 of the *Small Business, Enterprise and Employment Act 2015*

2 A 'fixed charge' may be define as a charge over a particular asset where the 'chargee' controls any dealing or disposal of the asset by the 'charger'. A fixed charge ranks before a floating charge in the order of repayment on an insolvency (see footnote 11 for a definition of a floating charge).

3 A secured creditor, in relation to a company, means a creditor of the company who holds in respect of his/her debt a security over property of the company. Security means, in relation to England and Wales, any mortgage, charge, lien, or other security.

4 The Insolvency Service, '*Annual Report on the Operation of Statement of Insolvency Practice 16'*, January/ December 2011

1.2 What is the difference between a pre-pack and a regular administration?

In a pre-pack administration, all the preparatory work for the sale of a company's assets/business is carried out in advance of formal administration (and usually before the creditors have been told about the failure of the business). Terms are pre-negotiated with a purchaser before an administrator is appointed and the sale contract is executed by the administrator as soon as appointed.

In a regular administration, the administrator begins managing and trading the business and conducting sales negotiations after being appointed. It follows from this that the regular administration process is usually slower and less predictable. The company can usually continue operating throughout the pre-pack administration process, making it possible to preserve brand integrity and retain customers and key employees.

The regular administration process is usually slower and less predictable.

1.3 Why are pre-packs used?

When a business needs to be rescued there are often worries about maintaining brand value – both for existing creditors and for prospective purchasers trying to restart the business. As a result, the practice of 'pre-packaging' the administration process has developed. The insolvency practitioner, the directors and the bank will have obtained valuations, agreed a sale price and drafted contracts before the administration order is made, thereby enabling the business to be sold immediately after the appointment of the administrator.

1.4 Effect of administration on employees

If a company in financial difficulty is put into administration (whether or not pre-packaged), it is possible that the business may carry on trading as a 'going concern'. If the administrator can find a buyer to take over all or part of the business as a going concern, some jobs may be saved (although there may still be redundancies). Employment contracts may be transferred to the buyer, with the employees' rights protected under special rules that apply to transfers of undertakings.

In contrast, if a company in financial difficulty is put immediately into liquidation, then all jobs will be lost. The company will no longer exist.

2. How are pre-pack administrations regulated?

Pre-packs are not specifically provided for in insolvency legislation; a company does not need the approval of its unsecured creditors or the permission of the court to initiate a pre-packaged administration procedure. However, an insolvency practitioner is an officer of the court and as such is required by law to ensure that a pre-pack sale provides the best outcome for creditors before recommending this course of action. In addition, administrators are required to adhere to a Statement of Insolvency Practice (SIP 16) a mandatory professional standard (see section 5 below).

In supplementary evidence given to the Business, Innovation and Skills (BIS) Select Committee, the Insolvency Service gave the following figures on the number and the level of fines that had been levied for SIP 16 non-compliance:

> Since January 2010 there have been a total of 6 fines given to insolvency practitioners by their authorising bodies for breaches of SIP 16. The fines ranged from £250 to £2,500 with costs attached ranging from £250 to £2,167. In 26 other cases, the authorising bodies took regulatory action resulting in 5 consent orders without financial penalty and 21 formal warnings. There are 10 SIP16 referrals currently with the authorising bodies for consideration.[5]

Box 1: Annual report on the operation of SIP 16

In May 2012, the Insolvency Service published its "*Report on the Operation of SIP 16, 1 January to 31 December 2011*"' (the most recent report available on the GOV.UK site). According to this report:[6]

- 32 per cent of cases reviewed during 2011 were not fully compliant with SIP 16 disclosure requirements;
- 29 cases (7 per cent of the sample) were referred to the relevant authorising body for being substantially deficient (cases were reported if they failed to provide enough detail or justification to support the pre-pack process or were not sufficiently timely);[7]
- some insolvency practitioners are failing to comply with requirements in SIP 16 to provide information on pre-appointment costs and expenses, and to obtain approval for them.[8]

A pre-pack administration (like any other administration) is under the ultimate control of the court. Once appointed, the administrator is

5 House of Commons Business, Innovation and Skills Committee, 'The Insolvency Service', Sixth Report of Session 2012-13', Evidence 67, [HC 675], 6 February 2013, [online] (accessed 2 September 2014)

6 *'Annual Report on the Operation of Statement of Insolvency Practice 16, 1 January to 31 December 2011',* Insolvency Service, 2012, [online] (accessed 19 January 2016)

7 *Ibid*

8 *Ibid*

required to act in the best interests of all the creditors.[9] If an insolvency practitioner is found by the court to have acted improperly, he may be made liable for misfeasance (i.e. performing a legal action in an improper way – a cause of action in the civil courts). If he is judged to have acted improperly by his professional body, he will be subject to that body's disciplinary proceedings.

Disqualification of company directors

In addition, the Insolvency Service has enforcement powers to clamp down on any directors who misuse the administration process to disadvantage creditors or seek to gain benefit for themselves. Directors of insolvent companies, which includes those going through administration, can be disqualified by the court for a period between 2 and 15 years if their conduct in the period leading to the insolvency proceedings is considered to be unfit.

9 In practice, the administrator may instruct agents to provide a report as to the likely realisable value of the assets and to advise on the best way in which to maximise value in all the available assets

3. Pros and cons of pre-pack administrations

The pros and cons of pre-pack administrations is a subject much debated within the Insolvency industry. Commenting on how pre-packs work in practice, the Association of Business Recovery Professionals (known as 'R3') has said:

> If the conditions are appropriate, a pre-pack can be advantageous for all involved, and can be the best way of extracting value from a dire situation.[10]

Box 2: Potential advantages of a pre-pack

It is argued variously that when undertaken in a professional manner, a pre-pack administration may offer some of the following benefits:

- Since the administration process is pre-negotiated, business operations are not interrupted or detrimentally affected
- Jobs may be saved
- Once the pre-pack sale has been arranged, a purchase contract has been drawn up, and an Insolvency practitioner has been appointed as an administrator, the courts keep the company protected from creditor pressure while the company's assets are sold
- Pre-packs prevents secured creditors from enforcing a charge against the company's property or assets – allows the company to avoid receivership and bankruptcy
- Assets of a company in financial difficulty may be sold at a higher price since the insolvency practitioner can negotiate with potential buyers before he/she has been formally appointed as administrator.

However in recent years, pre-pack sales have been criticised for their lack of transparency. In the majority of cases, sales were agreed prior to the first notification to creditors, and the sales were often made to connected parties (i.e. the existing management). This meant that by the time the creditors received the first report from the administrator, they were presented with the sale as a done deal, and thus had no opportunity to raise any queries or concerns.

For some creditors, there is a perception that company assets may have been sold at an undervalued price or that 'goodwill' may not have been fully valued because of the speed of the sale. The matter is further complicated if the purchaser is the existing management, with concerns raised as to the potential for abuse of the process by directors seeking to purchase assets at an advantageous price and simply avoid payment of creditors.

[10] The Association of Business Recovery Professionals (R3), 'Briefing on pre-packaged sales(pre-packs')', undated, [online] (accessed 2 September 2014)

Box 3: Potential disadvantages of a pre-pack

In recent years, pre-pack administrations have raised the following issues:

- Whether businesses are being sold at under-value, especially where this is to the previous owner or a connected party with no open market valuation
- Possible conflicts of interest for the insolvency practitioner, for instance, where there is close working with the directors or when appointed by the floating charge holder[11]
- Lack of involvement of unsecured creditors, who are only informed of the deal after it has taken place
- The role of advertising targeted at directors of distressed companies
- Giving an unfair market advantage by allowing the new company to leave behind its unwanted debts
- Causing longer-term economic harm by allowing inefficient businesses to carry on trading

The new rules introduced under SIP 16 are intended to answer these criticisms, by providing for greater transparency for creditors in the pre-pack administration process.

[11] A floating charge is a charge on company property that is constantly changing in value and identity (e.g. stock, book debts and work in progress). A floating charge does not attach to a specific item of property. The holder of a floating charge (e.g. a bank) has no right of possession of the assets covered by the charge until one of the events specified in the charge instrument causes the charge to 'crystallize' (i.e. a default on repayments of a loan).

4. Graham review of pre-pack administrations

The BIS Select Committee report on '*The Insolvency Service'* was published on 6 February 2013.[12] In respect of pre-pack administrations, the Select Committee concluded that they remain a controversial practice:

> 80. In May 2009, our predecessor Committee expressed concerns about the lack of transparency, resultant abuse of pre-pack administrations and their link to 'phoenix companies'. Despite the introduction of Statement of Insolvency Practice Note 16 and additional guidance, pre-pack administrations remain a controversial practice. The Insolvency Service is committed to continue to monitor SIP 16 compliance, but to make this effective, non-compliance needs to be followed through with stronger penalties by way of larger fines and stronger measures of enforcement.[13]

The Committee made the following recommendations:

- BIS and the Insolvency Service to commission research to renew the evidential basis for pre-pack administrations;
- the Insolvency Service to amend its monitoring processes to include feedback to each insolvency practitioner and their regulatory body where SIP 16 reports have been judged to be non-compliant; and
- the criteria by which SIP 16 reports are judged should be published alongside the guidance[14]

In July 2013, Vince Cable, then Business Secretary, announced the appointment of Teresa Graham CBE to undertake an independent review of pre-pack procedure. This followed a speech he gave on the issue of transparency and trust in business.[15] As part of this review, the University of Wolverhampton was commissioned to carry out research based on a large sample of pre-packs from 2010.

On 16 June 2014, a report on the 'Graham Review into Pre-pack Administration'[16] was published, together with a report on pre-pack empirical research, 'Characteristic and Outcome Analysis of Pre-pack Administration'.[17]

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[12] House of Commons Business, Innovation and Skills Committee, 'The Insolvency Service', Sixth Report of Session 2012-13', Evidence 67, [HC 675], 6 February 2013, [online] (accessed 2 September 2014)

[13] *Ibid*

[14] *Ibid*

[15] This review of pre-packs was part of a wider Government programme to improve corporate transparency. See Department for Business, Innovation and Skills, 'Transparency & Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business – Discussion Paper', July 2013, [online] (accessed 2 September 2014)

[16] "Graham Review into Pre-pack Administration – Report to The Rt. Hon Vince Cable MP", Teresa Graham CBE, June 2014, [online] (accessed 2 September 2014)

[17] Pre-pack Empirical Research: Characteristic and Outcome Analysis of Pre-Pack Administration – Final Report to the Graham Review", Prepared by Professor Peter Walton and Chris Umfreville with the assistance of Dr Paul Wilson, University of Wolverhampton, April 2014, [online] (accessed 2 September 2014)

Box 4: Conclusion of the Graham Report:

The Graham Report concluded that: "the benefits that pre-packaging brings to the UK's insolvency framework mean that reform of the process is worthwhile, however, there should be some major improvements to how they are administered".[18]

Importantly, the Graham Report proposed **voluntary scrutiny** of pre-pack deals rather than new legislation. It made six key recommendations, particularly targeted at sales to 'connected parties'; research had shown that creditor pay-outs were often worse, and the new business was less likely to succeed, following these kind of pre-pack deals.[19]

Box 5: A 'connected party' for the purposes of the Graham Report

Although the term 'connected party' is defined in the IA 1986, the Graham Report does not adopt this definition. Instead, a 'connected party' is taken to mean:

(a) a director, shadow director or company officer of the insolvent company;
(b) an associate[20] of a director, shadow director or company officer of the insolvent company; and
(c) an associate of the insolvent (pursuant to section 249 of the IA 1986) who becomes:

- a director, shadow director, company officer of the new company;
- exercises control over the new company as defined in section 435(10) of the IA 1986;[21]
- an associate of a director, shadow director or company officer of the new company; and
- an associate of the new company

[18] *Ibid*

[19] "Pre-pack Empirical Research: Characteristic and Outcome Analysis of Pre-Pack Administration – Final Report to the Graham Review", Prepared by Professor Peter Walton and Chris Umfreville with the assistance of Dr Paul Wilson, University of Wolverhampton, April 2014, [online] (accessed 2 September 2014)

[20] An 'associate' means any person set out in section 435 of the *Insolvency Act 1986* with the exclusion of subsection (4) which relates to employees (who are not directors or shadow directors

[21] For the purposes of determining whether any person or company has control of a company under section 435(10) of the *Insolvency Act 1986*, sales to secured lenders who hold security for the granting of the loan (with related voting rights) as part of the lender's normal business activities over one third or more of the shares in both the insolvent company and the new company are not included

Box 6: The Graham Report's six recommendations:

1. Create a pre-pack pool of experienced business people where, on a voluntary basis, details of a proposed sale to a 'connected party' could be disclosed to an independent person prior to the sale taking place, the aim being to increase transparency and give greater confidence to creditors that the deal has undergone independent scrutiny.

2. Request connected parties to complete a 'viability review' for the new company, stating how the company will survive for at least the next 12 months. A short narrative will also be provided, detailing what the new company will do differently from the old company in order that the business does not fail again. According to the Graham report, a new company in a connected pre-pack is more likely to fail than a new company unconnected with those controlling the old company. Empirical evidence shows that there is a clear link to future failure in connected party cases.[22]

3. The Joint Insolvency Committee to consider, at the earliest opportunity, a redrafted SIP 16 (found in Annex A of the Graham report). It is proposed that the documents required by the preceding two recommendations (i.e. a report by a pre-pack pool member and a viability review by a 'connected party') be sent with the redrafted SIP 16 statement.

4. All marketing of pre-pack businesses to comply with six 'good marketing' principles (stated in the report) in order to maximise sale proceeds and that any deviation from these principles be brought to creditors' attention.

5. SIP 16 to be amended to require valuations to be carried out by a valuer who holds professional indemnity insurance ('PII'), to increase confidence that the sale is for a fair price.

6. The Insolvency Service to withdraw from monitoring SIP 16 statements. Monitoring to be picked- up instead by the recognised professional bodies (RPBs), as they have the right level of practical experience to further improve compliance rates.[23]

The Graham Report also suggested that the Government should consider taking a reserve legislative power, in order that it could act should the measures outlined above fail to have the desired impact or are not adopted by the market. It recommended that any such reserve power should be time-limited by way of a 'sunset clause'.

Commenting on these six recommendations, the Government said that it supported the voluntary approach set out in the Graham report:

> Teresa Graham has come up with a set of recommendations which will ensure people get back as much money as possible and make pre-pack deals more transparent. We will be working with business and industry to implement these recommendations in full and we believe it will help restore trust and confidence in pre-pack deals. We will monitor progress loosely and will take the power to legislate if necessary.[24]

22 "Pre-pack Empirical Research: Characteristic and Outcome Analysis of Pre-Pack Administration – Final Report to the Graham Review", Prepared by Professor Peter Walton and Chris Umfreville with the assistance of Dr Paul Wilson, University of Wolverhampton, April 2014, [online] (accessed 2 September 2014)

23 "Graham Review into Pre-pack Administration – Report to The Rt. Hon Vince Cable MP", Teresa Graham CBE, June 2014, [online] (accessed 2 September 2014)

24 Department for Business, Innovation and Skills press notice, "Willott announces plans to clean up 'pre-pack' insolvency deals", 16 June 2014, [online] (accessed 2 September 2014)

5. Changes to pre-pack administrations

5.1 Compliance with the latest Statement of Insolvency Practice 16(SIP 16)

Since the 1 November 2015, insolvency practitioners have been required to comply with the latest Statement of Insolvency Practice (SIP 16) in connection with pre-pack administrations. The main changes to SIP 16 have been in the area of marketing (see Box 7).

Box 7: Insolvency Practice 16 (SIP 16)

SIP 16 sets out the 'marketing essentials' these essentials include:

- Broadcast – the business must be marketed as widely as possible.
- Justification of the strategy – explain the marketing and media strategy.
- Independence – ensure that they are satisfied as to the adequacy and independence of the strategy adopted in the marketing process, particularly important where marketing is taking place before the appointment takes effect.
- Publicise rather than just publishing – marketing should be over an appropriate length of time.
- Connectivity – include the use of online media alongside other marketing by default.
- Comply or explain – particularly where the sale is to a connected party with high levels of interest, an explanation needs to be given as to how the marketing strategy achieved the best result for creditors as a whole in all the circumstances.

Taken together, the administrator is required to carry out more transparent marketing of the business prior to the sale.

5.2 Creation of the Pre-Pack Pool

One of the key recommendations of the Graham report was that a pool of independent business people be set up in order to assess and give an opinion upon a proposed pre-pack sale to a 'connected person'. This recommendation was adopted, and a Pre-Pack Pool came into force on **2 November 2015**. Insolvency Practitioners now need to make 'connected party' purchasers aware of this pool, which operates exclusively online (see Box 8).

The process of using the Pre-Pack Pool is not compulsory, but it is considered best practice. It helps ensure transparency for creditors.

Box 8: The new Pre-Pack Pool

Since 2 November 2015, if a 'connected party' wishes to purchase a business that is about to go into administration, then it is recommended that they approach the Pre-Pack Pool, who will independently review the proposed deal prior to it being completed. Applications to the Pre-Pack Pool are submitted via an on-line portal (there is a fee).

Such a recommendation applies only to purchasers who are deemed to be a 'connected party'. A 'connected party' can be a director, shadow director or owner of an insolvent company, or an associate of these parties who then becomes the director, shadow director or owner of the new company.[25]

The application is considered by one Pre-Pack Pool reviewer, who can give one of three outcomes (usually within 48 hours, so to minimise any disruption) :

- the pre-pack purchase is not unreasonable; or
- the pre-pack purchase is not unreasonable, but there are minor limitations in the evidence provided; or
- the case for pre-pack has not been made out

A copy of the reviewer's opinion is attached to the administrator's SIP 16 report, which is then sent to creditors. A pre-pack deal can still go ahead, even if a negative statement is received from the pool of experts. However, the administrator would need to set out the reasons for doing so in the SIP 16 report to creditors.

It is important to note that referral to the Pre-Pack Pool by a connected purchaser is **only voluntary**. However, the administrator's SIP 16 report to creditors will be expected to disclose the reasons why the connected party decided not to approach the pool for sanction.

Obviously, the main aim of this voluntary scrutiny is to create confidence and transparency in a proposed deal to a connected party for the benefit of the creditors. The purchaser may also provide a voluntary viability review statement (see Box 9 below).

This reform has also been reinforced by a revised (SIP) 16 which strengthens the requirements for marketing and independent valuation in pre-pack administration deals.

[25] A connected party in this context only, does not include lenders with security by way of voting rights with more than one third of the shares of both the old company and the new company

5.3 Validity statement

Box 9: Viability Statements SIP 16

- A 'connected party' wishing to make a pre-pack purchase can draw up a viability statement essentially setting out how the purchasing entity (i.e. the business) will survive for at least the next 12 months, it is proposed that the statement should outline how things will be done differently.

- Any viability statement should be attached to the SIP 16 Statement made by the administrator.

- In the event that the statement is requested but not supplied creditors should be made aware of this in the SIP 16 Statement.

- The main aim is to create confidence and transparency in a proposed deal for the benefit of the creditors. However, it is important to note that submission of a viability statement for connected purchasers is **only voluntary**.

6. Assessment of impact of the voluntary industry measures

On 12 December 2017, the Insolvency Service announced that the Government would undertake an assessment of the impact of the voluntary industry measures, introduced in November 2015, to improve the transparency of connected party pre-pack sales in administration. As part of this assessment, it would be contacting a variety of interested parties to seek their views.[26]

As outlined above, the industry measures arose from the recommendations of the 2014 independent Graham Review, which found that pre-pack sales were a useful business rescue tool, but that there was evidence of less successful outcomes where the pre-pack sale was to a connected party.

As well as industry reforms, the Small Business, Enterprise and Employment Act 2015 created a power for Government to make regulations to impose conditions on property sales to connected parties in administration (including via a pre-pack) (see below). This power expires in **May 2020**.

According to the Insolvency Service, the assessment will look at the impact of reforms on all connected party sales in administration and will help to inform decisions on whether further regulation is needed prior to the expiration of the regulation making power.

[26] Insolvency Service, "An assessment of the impact of the voluntary industry measures introduced in November 2015 is to be undertaken", 12 December 2017, [online] (accessed 17 December 2017)

7. Small Business Enterprise and Employment Act 2015

Part 10 of the *Small Business, Enterprise and Employment Act 2015* (SBEEA 2015), which received Royal Assent on 26 March 2015, must also be taken into account by restructuring and insolvency practitioners. This wide-ranging Act includes a number of measures to amend various parts of the current insolvency framework and modernise insolvency law by removing unnecessary costs and regulatory burdens. Further detailed information is set-out below.

Aims of the SBEEA 2015: to ensure that the UK continues to be a trusted and fair place to do business; to open up opportunities for small businesses to innovate and compete.

7.1 New reserve power for the Secretary of State to intervene

The SBEEA 2015 creates a reserve power for the Secretary of State to make regulations in the future to either prohibit administration sales to connected parties or to impose conditions or requirements to allow a connected party administration sale to proceed. [27] This would include connected 'pre-pack' sales. This reserve power lapses five years after commencement, on **26 May 2015**, unless it is exercised during that period. It is envisaged that this reserve power would only be used if the voluntary measures arising from the Graham Report prove unsuccessful (see section 5 above).

Effectively, this reserve power leaves open the potential for more stringent reforms to be introduced by the Government should this be deemed necessary. The Insolvency Service will be monitoring progress.[28]

7.2 Administrators' ability to bring wrongful and fraudulent trading claims

Previously, claims under the IA 1986 for wrongful trading and fraudulent trading were only available to liquidators, not to administrators. In practice, this meant that a company in administration could move directly to dissolution (without any intervening liquidation) without such claims having been considered by an Insolvency Practitioner. Alternatively, in order to pursue a wrongful or fraudulent trading claim, the administrator would first have to put the company into liquidation.

The SBEEA 2015 has changed the situation.[29] Specifically, the Act inserts new sections into the IA 1986, to allow an administrator (as well as a liquidator) to bring claims against directors for fraudulent trading and wrongful trading.[30] These provisions came into force on **1 October 2015**.

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[27] Section 129(4) of the *Small Business, Enterprise and Employment Act 2015*

[28] The Insolvency Service is an executive agency of the Department for Business Innovation and Skills (BIS)

[29] Sections 117 to 119 of the *Small Business, Enterprise and Employment act 2015*

[30] New sections 246ZA and 246ZB to be inserted into the *Insolvency Act 1986* by the *Small Business, Enterprise and Employment act 2015*. The wording of the new clauses

In effect, it is now possible for an administrator to consider potential avenues of recovery during the administration process, rather than delay any investigation until such time as the company moves from administration into liquidation (which may not occur). This should increase the potential for more claims to be brought, and more quickly, for the benefit of the creditors.

Under the SBEEA 2015, administrators and liquidators can also assign causes of action to third parties. Further details are set out below.

7.3 Administrator's right to assign wrongful and fraudulent trading claims

Prior to the SBEEA 2015, administrators and liquidators could only assign causes of action which vest in the company (such as misfeasance claims) but not actions which vest in the office-holder personally. The situation has now been changed by provisions of the SBEEA 2015, which came into force on **1 October 2015**.[31]

Specifically, the Act inserts new sections into the IA 1986,[32] which allows liquidators and administrators to assign the following rights of action to third parties:

- fraudulent trading[33]
- wrongful trading[34]
- transactions at an undervalue[35]
- preference transactions[36]; and
- extortionate credit transactions[37]

In addition to conferring the ability to assign such claims, the SBEEA 2015 inserts a new section 176ZB into the IA 1986. New section 176ZB specifically provides that any proceeds recovered from any of the above listed claims (or recoveries made pursuant to an assignment of such claims) will not be treated as part of the company's net property for distribution to the holders of any floating charge created by the company.[38]

of action mirror the claims available to liquidators under sections 213 and 214 of the *Insolvency Act 1986*

31 Sections 117 to 119 of the *Small Business, Enterprise and Employment Act 2015* commenced on 1 October 2015 pursuant to the *Small Business, Enterprise and Employment Act 2015 (Commencement No.2 and Transitional Provisions) Regulations 2015*, 2015 No.1689

32 New section 246ZD of the *Insolvency Act 1986*

33 Section 213 of the *Insolvency Act 1986*

34 Section 214 of the *Insolvency Act 1986*

35 Section 238 of the *Insolvency Act 1986*

36 Section *239 of the Insolvency Act 1986*

37 Section 244 of the *Insolvency Act 1986*

38 A floating charge is a charge on company property that is constantly changing in value and identity (e.g. stock, book debts and work in progress). A floating charge does not attach to a specific item of property. The holder of a floating charge (e.g. a bank) has no right of possession of the assets covered by the charge until one of the events specified in the charge instrument causes the charge to 'crystallize' (i.e. a default on repayments of a loan).

Litigation is expensive and funding options are sometimes limited. It is hoped that the ability to assign such claims will ensure that fewer actions are hindered due to lack of funding which in turn will lead to more certainty and a quicker return to creditors.[39]

By way of further background information, Part 2 of the *Legal Aid, Sentencing and Punishment of Offenders (LASPO) Act 2012* reformed the operation of 'no win, no fee' conditional fee agreements (CFAs). Those reforms came into effect generally in April 2013 but were delayed in respect of insolvency proceedings. However, on 17 December 2015, the Government announced that the current exemption would end on **1 April 2016**.[40] In effect, as from this date officeholders will no longer be able to recover 'no win, no fee' CFA success fees and after-the-event (ATE) insurance premiums from losing defendants.

Taken together, all these amendments should provide increased flexibility for officeholders to take action for the benefit of unsecured creditors.

7.4 Administrator's fees

The *Insolvency (Amendment) Rules 2015* came into force on **1 October 2015**.[41] They amended the 1986 Insolvency Rules to introduce a new approach to the approval and payment of insolvency office holders' fees and disbursements.

Administrators, liquidators and trustees in bankruptcy are now obliged to provide fee estimates to creditors, giving details of the likely remuneration they will charge, and any expenses likely to be incurred in the case. [42] These estimates must be provided before the basis of the officeholder's remuneration is determined. The approval of the fee estimate will then effectively cap remuneration at that level, unless further approval is sought. It should be noted, however, that this obligation does not apply to supervisors of Individual Voluntary Arrangements (IVAs), Company Voluntary Arrangements (CVAs) or to a liquidator in a Members' Voluntary Liquidation (MVL).

7.5 Changes being made to the position of creditors

The SBEEA 2015 also introduces a number of changes to the *Insolvency Act 1986* (IA 1986) aimed at streamlining insolvency processes and removing unnecessary administrative burdens. These changes are expected to come into force in **October 2016.**

Deemed consent procedure

Currently, administrators are required to hold physical meetings with creditors in most cases. As a result of changes to be introduced by the SBEEA 2015 , physical meetings will be prohibited except where creditors request them. Instead, Insolvency Practitioners (in both corporate and individual insolvencies) will be able to make use of the 'deemed consent procedure' when creditors are asked to make a decision about any matter. In a nutshell, the Insolvency Practitioner will

39 New section 176ZB of the *Insolvency Act 1986*
40 HL Deb. 17 December 2015 c410WS
41 2015 No.443
42 Although an estimate of expenses is required, there is no requirement for the expenses to be approved

provide a notice with details of the proposed decision, and an explanation of how to object. If less than 10 per cent in value of creditors object to the proposed decision, it will be deemed to have been approved.[43]

Decisions will be able to be made in this way unless the IA 1986 or the Court requires that a 'qualifying decision procedure' is to be followed. These procedures are to be set out in the Insolvency Rules; it is anticipated that these will involve virtual meetings, electronic voting or meetings by correspondence.

It is important to note that creditors will still retain the right to request that the Insolvency Practitioner summon a meeting (see Box 10).

Box 10: Creditors requesting the holding of meetings under the SBEEA 2015

- The new rules provide that creditors representing at least 10% in number or value or 10 creditors in total (i.e. any one of these criteria) can require a meeting to be held.
- In effect, only a relatively small number of creditors can request a meeting in most cases.
- It is important to note that Company Voluntary Arrangement (CVA) and Individual Voluntary Arrangement (IVA) meetings will continue to be held in all cases. These meetings are held to decide whether to approve the proposals put forward by a company (CVA) or individual (IVA) for a compromise arrangement with their creditors; the outcomes are binding on all creditors.

Creditors will also be able to opt out of being sent paperwork regarding insolvencies. The aim being to reduce unnecessary costs associated with meetings being held where, for example, no one turns up, as well as large amounts of paperwork being printed and sent that simply isn't read.

The onus is very much on the creditors: they can still have meetings and paperwork if they want.

Once implemented in October 2016, it is hoped that these changes will reduce the cost and delay incurred by arranging creditor meetings. However, some commentators have expressed concern that the views of creditors may not be adequately addressed without actual meetings taking place; in particular, in relation to so-called section 98 and paragraph 51 meetings (see Box 11).

43 Sections 246ZE to section 246ZG of the *Small Business, Enterprise and Employment Act 2015* for corporate matters, and sections 379ZA to 379ZC of the Act for individual insolvencies

Box 11: Section 98 and paragraph 51 meetings

A section 98 meeting is the meeting of creditors immediately after the company is placed into creditors' voluntary liquidation and at which the liquidators' appointment is confirmed by the creditors. This is the time when creditors can:

- ask questions of the directors, and
- influence who is appointed as liquidator

A paragraph 51 meeting is the equivalent in administration proceedings where creditors discuss and vote on the administrator's proposals.

Some commentators are concerned that fewer of these meetings will actually happen – potentially resulting in less creditor engagement and less scrutiny of directors' conduct.

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